NFIB®

The Voice of Small Business

Charles S. Owens, State Director
National Federation of Independent Business
115 W. Allegan / Suite 310
Lansing, MI 48933
(517) 485-3409

Testimony in Support of House Bills 4781 and 4782
Unemployment Insurance Reform Proposal
Before the House Commerce Committee
Wednesday, June 22, 2011

My name is Charlie Owens and I am the State Director for the National Federation of Independent Business, an advocate for Michigan small businesses owners and we are here today to support the Unemployment Insurance Reform package of bills HB 4781 and 4782.

As we move forward on the important mission of creating more and better jobs for the citizens of Michigan, we must consider the impact of payroll taxes, such as the Unemployment Insurance (UI) tax, on the overall business climate for our state.

Michigan's Unemployment Insurance system is 100 percent totally funded by taxes applied to an employer's payroll. There is no taxpayer money from the general public or general fund used to support the program. There is no contribution by employees. The Federal Unemployment Insurance system is also totally funded by employer taxes. Every business in the state that has employees is required to participate in the Unemployment Insurance system and pay the payroll tax. It is a violation of law not to do so. Michigan's system works in tandem with the federal system.

The bottom line is that taxes will be going up for Michigan employers over the coming years as a number of the tax formula provisions in both the State Unemployment Tax Act (SUTA) and the Federal Unemployment Tax Act (FUTA) are triggered on due to outstanding federal debt and an insolvent state UI Trust Fund. This will occur without any action on the part of the state legislature or Congress.[1]

Our state has already made an important first step in addressing the cost to employers of the UI payroll tax with the recent change in reducing the benefit weeks from 26 to 20 that will be in effect beginning next year. Many believe that this is enough reform to our UI system and no more is needed. In Michigan, this is not the case and further reforms are appropriate because of our unique circumstances relative to other states with our UI system and the UI Trust Fund.

No other state UI system or Trust Fund is in more serious difficulty than Michigan. As noted in the attachment table[2], when examined on a per capita or loan per covered employee basis, Michigan has more outstanding debt to the Federal Unemployment Account than any other state. Therefore, in addition to adjustments on the revenue side of the equation, all means of reform that would impact the outflow of funds from our state UI Trust Fund must be considered if the Fund is to be restored to solvency.

The generally accepted principle of unemployment insurance at both the state and federal level is that unemployment compensation benefits are paid to individuals who have had some attachment to the labor force, are unemployed through no fault of their own, and are able, available and actively seeking fulltime suitable employment. This can be seen in the intent language of the Michigan Act – Public Act 1 of 1936: "…to provide benefits for periods of unemployment by the setting aside of unemployment reserves to be used for the benefit of persons unemployed **through no fault of their own…**". However, over the years, this principal has been eroded by making it easier for claimants to qualify for benefits in many situations where it can be argued that the circumstances of unemployment are more of the claimants doing than any action on the part of the employer.

These reform bills attempt to return to the original intent of the act by strengthening the work search requirements, suitable work criteria and clarifying the disqualifying reasons for separation. The bills also make technical corrections to areas of the Act that need improvement such as the seasonal employer definitions and the calculation of the weekly benefit amount. These changes will help assure the integrity of the UI Trust Fund in the coming years.

We urge the members of the Committee to support these important reforms.

Attachments:

[1] Credit Reduction; Congressional Research Service; The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States; Julie M. Whittaker; February 8, 2011

[2] Michigan Loan Status;Congressional Research Service; The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States; Julie M. Whittaker; February 8, 2011

Credit Reduction

The credit reduction is initially 0.3 percentage points for the year beginning with the calendar year in which the second consecutive January 1 passes during which the loan is outstanding and increases by 0.3 percentage points for each year there is an outstanding loan. (For example, in the first year, the credit reduction results in the net federal tax rate increasing from 0.8% to 1.1%—an additional $21 for each employee; in the second year, it would increase to 1.4%—a cumulative additional $42 for each employee. For example, Michigan had a second year of credit reduction. As a result, the credit reduction was applied retroactively to tax year 2010 earnings, and Michigan employers paid a net FUTA tax of 1.4% on the first $7,000 of each employee's earnings.)

There are two potential additional credit reductions (in addition to the cumulative 0.3 percentage point increases) during the ensuing calendar years in which a state has an outstanding loan: (1) in the calendar years after which the third and fourth consecutive January 1s pass and (2) in the calendar years after which the fifth or more consecutive January 1s pass. The first additional credit reduction (referred to as the "2.7 add-on") uses a statutory formula that takes into consideration the average annual wages and average employment contribution rate. The second credit reduction (referred to as the Base Credit Reduction, or BCR, add-on) replaces the 2.7 add-on and uses the five-year benefit cost rate as well as average wages in its calculation.[8] **Table 2** presents these reductions and the subsequent net FUTA tax faced by state employers as a result of these unpaid loans.

Table 2. Schedule of State Tax Credit Reduction and Net Federal Unemployment Tax Act (FUTA) Tax

Loan Year	Credit Reduction	Additional Reductions	Net FUTA Tax
Year 1 of outstanding loan	0.0%	None	0.8%
Year 2 (applied retroactively at end of calendar year)	0.3%	None	1.1%
Year 3	0.6%	2.7 Add-on	1.4% or more
Year 4	0.9%	2.7 Add-on	1.7% or more
Year 5	1.2%	BCR Add-on	2.0% or more
Year 6	1.5%	BCR Add-on	2.3% or more
Year 7	1.8%	BCR Add-on	2.6% or more
Year 8	2.1%	BCR Add-on	2.9% or more
Year 9	2.4%	BCR Add-on	3.2% or more
Year 10	2.7%	BCR Add-on	3.5% or more
Year 11	3.0%	BCR Add-on	3.8% or more
Year 12	3.3%	BCR Add-on	4.1% or more
Year 13	3.6%	BCR Add-on	4.4% or more
Year 14	3.9%	BCR Add-on	4.7% or more

[8] The 2.7 add-on formula is: [(2.7% x 7000/ U.S. Annual Average Wage)-Average Annual State Tax Rate on Total Wages] x State Annual Average Wage/7000. The BCR add-on formula is: Max [five-year State Average Cost/Taxable Wages, 2.7] - Average Annual State Tax Rate on Total Wages.

Loan Year	Credit Reduction	Additional Reductions	Net FUTA Tax
Year 15	4.2%	BCR Add-on	5.0% or more
Year 16	4.5%	BCR Add-on	5.3% or more
Year 17	4.8%	BCR Add-on	5.6% or more
Year 18	5.1%	BCR Add-on	5.9% or more
Year 19	5.4%	BCR Add-on	6.2%

Source: U.S. Department of Labor, Employment and Training Administration.

Notes: 2.7 Add-on= [(2.7% x 7000/ U.S. Annual Average Wage)-Average Annual State Tax Rate on Total Wages] x State Annual Average Wage/7000.

Base Credit Reduction (BCR) Add-on= Max [five-year State Average Cost/Taxable Wages, 2.7] - Average Annual State Tax Rate on Total Wages.

How the Credit Reduction May be Mitigated: Avoidance or Cap

Section 272 of P.L. 97-248 allows a delinquent state the option of repaying—on or before November 9—a portion of its outstanding loans each year through transfer of a specified amount from its account in the UTF to the FUA. If the state complies with all the requirements listed below, the potential credit reduction is avoided (there is no reduction).

- The state also must repay all loans for the most recent one-year period ending on November 9, plus the potential additional taxes that would have been imposed for the tax year.
- In addition, the state must have sufficient amounts in the state account of the UTF to pay all compensation for the last quarter of that calendar year without receiving a loan.
- Finally, the state must also have altered its state law to increase the net solvency of its account with the UTF.

Cap

Once a state begins to have a credit reduction, the state may apply to have the reductions capped if the state meets four criteria:

- No legislative or other action in 12 months ending September 30 has been taken to decrease state unemployment tax effort.
- No legislative or other action has been taken to decrease the state trust account's net solvency.
- Average state unemployment tax rate on total wages must exceed the five-year average benefit cost rate on total wages.
- Balance of outstanding loans as of September 30 must not be greater than the balance three years before.

Table 1. State Unemployment Trust Fund Accounts: Financial Information by State, 3rd Quarter 2010

State	Revenues Last 12 Months ($ thousands)	Trust Fund Balance ($ thousands)	Trust Fund Ratio to Total Covered Wages	Average High Cost Multiple (AHCM)	Loan per Covered Employee ($)	Percentage of Loans to Yearly Total Wages in Covered Employment
Alabama	$407,748	$132,531	0.25	N.A	$163	0.52%
Alaska	121,894	258,036	2.44	1.24	—	—
Arizona	350,442	10,970	0.01	0.23	52	0.15
Arkansas	340,126	96,846	0.32	N.A	301	1.08
California	5,406,058	106,323	0.02	N.A	598	1.45
Colorado	448,121	21,140	0.03	0.08	145	0.37
Connecticut	698,289	126,802	0.18	N.A	323	0.69
Delaware	89,751	1,430	0.01	0.23	39	0.10
District of Columbia	139,658	322,947	1.16	1.18	—	—
Florida	1,208,418	118,941	0.05	N.A.	231	0.71
Georgia	663,189	76,518	0.06	N.A.	115	0.33
Hawaii	150,392	14,963	0.09	0.42	—	—
Idaho	245,213	84,262	0.54	N.A.	352	1.28
Illinois	1,939,781	205,279	0.10	N.A.	423	1.08
Indiana	568,707	18,262	0.02	N.A.	700	2.27
Iowa	475,058	313,962	0.79	0.70	—	—
Kansas	344,963	109,745	0.25	0.25	70	0.20
Kentucky	446,798	78,473	0.16	N.A.	486	1.64
Louisiana	200,614	957,376	1.72	2.06	—	—
Maine	138,355	290,390	2.00	1.20	—	—
Maryland	800,826	418,345	0.49	0.13	59	0.16
Massachusetts	1,703,075	531,317	0.39	0.09	128	0.28
Michigan	1,533,401	490,409	0.42	N.A.	1,057	3.14
Minnesota	936,326	8,883	0.01	N.A.	215	0.61
Mississippi	115,153	374,608	1.42	1.71	—	—
Missouri	589,707	93,028	0.12	N.A.	292	0.92

State	Revenues Last 12 Months ($ thousands)	Trust Fund Balance ($ thousands)	Trust Fund Ratio to Total Covered Wages	Average High Cost Multiple (AHCM)	Loan per Covered Employee ($)	Percentage of Loans to Yearly Total Wages in Covered Employment
Montana	102,766	116,421	1.06	1.20	—	—
Nebraska	196,646	232,124	0.98	0.99	—	—
Nevada	287,589	36,851	0.10	N.A.	487	1.35
New Hampshire	152,006	6,278	0.03	0.09	—	—
New Jersey	2,221,489	258,919	0.16	N.A.	482	1.07
New Mexico	134,953	138,731	0.66	1.19	—	—
New York	2,923,828	527,678	0.14	N.A.	394	0.87
North Carolina	826,743	19,224	0.02	N.A.	626	1.96
North Dakota	70,542	89,628	0.98	1.15	—	—
Ohio	1,221,009	266,986	0.18	N.A.	492	1.55
Oklahoma	175,864	320,528	0.75	1.16	—	—
Oregon	772,215	928,108	1.98	0.89	—	—
Pennsylvania	2,408,068	508,589	0.29	N.A.	574	1.67
Puerto Rico	180,465	329,742	2.12	0.93	—	—
Rhode Island	226,310	53,859	0.40	N.A.	531	1.66
South Carolina	285,078	81,570	0.17	N.A.	524	1.81
South Dakota	70,706	27,516	0.30	N.A.	—	—
Tennessee	707,644	210,977	0.26	0.20	—	—
Texas	2,234,630	40,073	0.01	N.A.	152	0.40
Utah	146,205	345,715	1.04	1.35	—	—
Vermont	84,512	7,713	0.10	0.16	116	0.43
Virgin Islands	1,177	487	0.05	N.A.	366	1.54
Virginia	502,668	163,866	0.13	N.A.	105	0.27
Washington	1,292,310	2,380,415	2.43	1.19	—	—
West Virginia	196,182	93,560	0.53	0.43	—	—
Wisconsin	890,707	191,208	0.26	N.A.	564	1.86
Wyoming	81,868	125,569	1.64	1.49	—	—

Source: Employment and Training Administration, U.S. Department of Labor, *Unemployment Insurance Data Summary*, 3rd Quarter 2010 Report, Washington, DC, 2010, Table: Financial Information by State for CYQ 2010.3, http://www.ows.doleta.gov/unemploy/content/data_stats/datasum10/DataSum_2010_3.pdf.

Notes: Total covered wages are based on extrapolated wages for the most recent 12 months. Trust Fund Balance does not include outstanding debt. States may have obligated some portion of their UTF funds and may be borrowing to fund unemployment benefits even if the state's UTF balance appears to be positive.
N.A.= Not Applicable: these states have outstanding debt that exceed their fund balances. Conversely, "—"= no outstanding loan.